1-2006

Singapore: A Tax Compact for the Future?

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Published as Asian Analysis, 2006

http://www.afgventuregroup.com/asian_analysis/

Raising its growth forecast for the fourth time this year, Singapore's 2006 economic growth forecast is now an impressive 7.5-8.0 per cent. The government also anticipates, however, that economic growth will dip to between 4 and 6 per cent in 2007. Arguing that the healthy economy provides the opportunity to introduce changes, the government has also just announced its intention to increase the Goods and Services Tax (GST) from 5 to 7 per cent most likely from the next financial year beginning in April 2007. Details are expected to be released in the Budget speech in February 2007.

The proposed increase in GST has been rationalised and justified squarely on the need to fund the expected increase in social spending in view of Singapore's rapidly ageing population and to manage the threat that a widening income gap poses to Singapore's social cohesion. Since 1997, while incomes of the top 20 per cent grew about 4 per cent per year, incomes of the bottom 20 per cent grew only 0.3 per cent annually. The prognosis for the latter group is not good given that about half of Singapore's workforce do not have post-secondary education.

Indirect taxes, like the GST, are seen as a good way to generate the requisite revenue. The government is desirous to keep its spending, currently only about 15 per cent of the GDP, lean. There is also the imperative to further reduce the current corporate tax rate of 20 per cent in order to remain competitive. Further, the government also plans to amend the Constitution to enable it to have greater access to the 'Net Investment Income' (NII) from its past reserves. Currently, the NII includes dividends and interest only. The proposed amendment will include capital gains as part of the NII.

To help the poor cope with the GST increases, the government will provide offset packages that will shelter the poor from the GST burden. However, it will be the 'sandwiched' segment, comprising ordinary middle-class workers, which may bear the disproportionate impact of the GST increase. Many in this group will probably not qualify for the offset package. As a substantive part of their disposable income goes towards consumption, they will feel the burden of the GST increase more than the top 20 per cent earners.

The current focus on the threat to jobs (that the bottom 20 per cent customarily faces as their jobs get off-shored or out-sourced) may have underestimated the threat to wages that the sandwiched segment faces. These workers may still have their jobs but their wages are stagnant relative to the rising costs and tax burdens.

The principle of the better-off helping the less well-off is noble and hard to argue against. Yet, it is important that Singaporeans are persuaded that the increased revenue to government coffers - generated by the 2 per cent GST increase and the changes to what constitutes the NII - will indeed go towards the provision of a comprehensive but sustainable social spending programme.

WATCHPOINT: Capitalising on its own call for a social and political compact, and with the inevitable tiering of Singapore society between the haves and the haves-not, the government will urge Singaporeans to internalise the process of the 'winners' of globalization helping the 'losers'.